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<sup>1</sup> Public Notice, DA 98-2092, released October 16, 1998.

reasonable, and not unreasonably discriminatory, and also remains necessary to protect consumers.

Premature relaxation of the depreciation rules would permit the ILECs to inflate their rates by overstating depreciation expense, which represents a significant portion of the operating expenses of an incumbent ILEC. Even under the Commission's price cap plan, accounting costs, including reported depreciation expense, still a key role in the ratemaking process. Overstated depreciation expense would distort the Commission's monitoring of the price cap regime and could also lead to erroneous triggering of the low-end adjustment mechanism.

Furthermore, state commissions rely heavily on the Commission's expertise and determinations, and generally prescribe depreciation parameters for intrastate ratemaking which rely on those prescribed by the Commission. The maintenance of just and reasonable intrastate rates is thus often dependent on Commission regulation of depreciation. Moreover, many state commissions have adopted Commission-prescribed depreciation factors, or similar state prescribed factors, for use in determining unbundled network element prices. The forward-looking cost studies that underlie the Commission's universal service plan also rely on Commission-prescribed depreciation rates.

Contrary to the ILECs' contentions, Generally Accepted Accounting Principles (GAAP) alone would not be sufficient to protect the ILECs' customers. As the Commission has noted previously, while the "conservatism" principle that underlies GAAP is effective in protecting the interests of investors, it may not always serve the

interest of ratepayers. Commission depreciation regulation remains necessary to protect ratepayers.

## **II. NPRM Proposals**

### **A. Depreciation Regulation Will Remain Necessary As Long As Incumbent LECs Retain Market Power**

In the NPRM, the Commission seeks comment on SBC's proposal that the Commission remove itself completely from the prescription of depreciation rates for price cap carriers.<sup>2</sup> The Commission tentatively concludes, however, that elimination of depreciation regulation at this time would have an adverse impact on several critical areas.<sup>3</sup> The Commission states that the depreciation process would become unnecessary only when the local exchange markets are characterized by robust competition – a level of competition that the Commission finds does not exist today.<sup>4</sup>

MCI WorldCom agrees with the Commission's assessment of the state of local competition, and also agrees with the Commission's tentative conclusion that depreciation regulation is still necessary. All evidence indicates that the ILECs retain overwhelming market power in the provision of local exchange and exchange access services. Indeed, the Commission itself recently noted that "[c]ompetition is still in its infancy in the vast majority of local areas," and that "incumbent LECs continue to dominate the market for local exchange and exchange access services to business

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<sup>2</sup> NPRM at ¶11.

<sup>3</sup> Id. at ¶19.

<sup>4</sup> Id. at ¶7.

customers.”<sup>5</sup> The ILECs’ continued market power is demonstrated by the fact they collected 97 percent of the industry’s 1997 local service revenues.<sup>6</sup>

At the current level of competition, depreciation regulation remains necessary to ensure that ILEC rates are just, reasonable, and not unreasonably discriminatory. Premature relaxation of the Commission’s depreciation rules would permit the ILECs to inflate their rates by overstating depreciation expense, which represents a significant portion of the operating expenses of an incumbent LEC – on average, about 28 percent.<sup>7</sup> The Supreme Court has ruled that excessive depreciation represents an unwarranted contribution of capital by ratepayers.<sup>8</sup> The preservation of just and reasonable rates thus requires the continued regulation of depreciation by the Commission.

#### **1. Price Caps Do Not Eliminate the Need For Depreciation Regulation**

SBC and other incumbent LECs contend that price cap regulation has eliminated the need for depreciation regulation to ensure just and reasonable rates.<sup>9</sup> The facts do not support this contention.

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<sup>5</sup> Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., Memorandum Opinion and Order, CC Docket No. 97-211, released September 14, 1998, ¶¶168, 172.

<sup>6</sup> Telecommunications Industry Revenue: 1997, Industry Analysis Division, Federal Communications Commission, October 1998, Table 4.

<sup>7</sup> 1997 Preliminary Statistics of Communications Carriers, Table 2.9.

<sup>8</sup> *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151, 78 L.ed. 1182, 54 S.Ct. 658 (1934).

<sup>9</sup> NPRM at ¶4.

**a. Interstate rates depend upon depreciation regulation**

First, the Commission's price cap plan's low-end adjustment mechanism allows price cap ILECs to increase their rates if their earnings fall below 10.25 percent.<sup>10</sup>

Without Commission depreciation oversight, a LEC could book excessive depreciation to take unfair advantage of this mechanism.

Depreciation regulation is also necessary to ensure effective monitoring of ILEC price cap performance. Earnings levels far in excess of an ILEC's cost of capital are both a sign of market power and an indication that the existing productivity factor is too low. The premature deregulation of depreciation would allow ILECs to charge excessive depreciation, reducing their reported earnings and masking the need for a higher productivity factor.

As the Commission notes in the NPRM, prescribed depreciation rates are also used in recalculating the price cap productivity index and in developing the end user common line charge.<sup>11</sup> In addition, Commission depreciation factors provide a basis for evaluating the service cost studies submitted by the ILECs to support exogenous factor adjustments, new service rates and rates above existing price caps.<sup>12</sup> The use of

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<sup>10</sup> Id., footnote 23.

<sup>11</sup> Id., para. 6.

<sup>12</sup> Id.

excessive depreciation factors in these calculations and studies would result in rates above just and reasonable levels.

**b. Universal service calculations depend upon depreciation regulation**

The Commission's universal service plan is intended to provide assistance to high cost areas based upon an analysis of forward-looking costs. As the Commission has recognized, the development of these costs requires the use of appropriate depreciation factors.<sup>13</sup> For example, the Commission required state commissions submitting cost studies to use depreciation parameters within the ranges prescribed by the Commission.<sup>14</sup> The Commission has also proposed the use of a weighted average of Commission prescribed factors in the development of universal service costs.<sup>15</sup> The premature deregulation of depreciation would open the door to the use of excessive depreciation factors that would inflate universal service subsidies and contributions.

**c. State commissions value Commission depreciation regulation**

Eighteen state commissions and the District of Columbia continue to set intrastate rates based on traditional rate of return regulations. Many of the remaining 32 states have limited the term of their price cap or incentive regulation plans, calling for

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<sup>13</sup> Id.

<sup>14</sup> Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 97-157 (released May 8, 1997) at ¶250.

<sup>15</sup> Id., Further Notice of Proposed Rulemaking, FCC 97-256 (released July 18, 1997) at ¶ 152.



earnings reviews at the end of those terms. Almost all price cap states monitor earnings so as to be able to adjust their formulas as required.

Many of the state commissions participate in "three-way meetings" with the Commission and ILECs, and prescribe depreciation parameters for intrastate ratemaking which generally agree with those prescribed by the Commission. Indeed, some state commissions lack the resources to independently evaluate LEC filings and rely heavily upon the Commission's expertise and determinations. The maintenance of just and reasonable intrastate rates is thus often dependent on Commission regulation of depreciation.

This reliance has now extended to the state commission calculation of Total Element Long-Run Incremental Costs ("TELRIC") for use in the determination of rates for unbundled network elements ("UNEs"). Many state commissions have adopted Commission-prescribed depreciation factors, or similar state prescribed factors, for use in these TELRIC calculations.<sup>16</sup>

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<sup>16</sup> See, e.g. Texas, Docket 16189, et al., November 8, 1996; Massachusetts, Docket DPU 96-73/74 et al., December 4, 1996; New York, Docket 95-C-0657, et al., April 1, 1997; West Virginia, Docket 96-1516-T-PC, April 21, 1997; Wyoming, Docket 70000-TF-96-319, 72000-TF-96-95, April 23, 1997; Delaware, Docket 96-324, April 29, 1997; Ohio, Docket 96-922-TP-UNC, June 19, 1997; Colorado, Docket 96S-331T, July 28, 1997; Maryland, Docket 8731, Phase II, September 22, 1997; Louisiana, Docket U-22022/22093, October 22, 1997; Georgia, Docket 7061-U, December 16, 1997; Illinois, Docket 96-0569, February 17, 1998; Virginia, Docket 970005, May 22, 1998.

**2. GAAP is not an adequate substitute for Commission depreciation regulation**

USTA and SBC have argued that Commission depreciation regulation could be replaced by a reliance on Generally Accepted Accounting Principles ("GAAP").<sup>17</sup>

But GAAP is governed by the conservatism principle, which GTE has noted "prefers the understatement (versus overstatement) of net income and net assets where any potential measurement problems exist."<sup>18</sup> In its October 1993 Depreciation Simplification Order, the Commission agreed with GTE, stating:

One of the primary purposes of GAAP is to ensure that a company does not present a misleading picture of its financial condition and operating results by, for example, overstating its asset values or overstating its earnings, which would mislead current and potential investors. GAAP is guided by the conservatism principle which holds, for example, that when alternative expense amounts are acceptable, the alternative having the least favorable effect on net income should be used. Although conservatism is effective in protecting the interest of investors, it may not always serve the interest of ratepayers. Conservatism could be used under GAAP, for example, to justify additional (but, perhaps not "reasonable") depreciation expense by a LEC....<sup>19</sup>

In regulating depreciation, the Commission balances the interests of both investors and ratepayers. Since this balance is lacking in GAAP, reliance on GAAP alone would not adequately protect consumers. Commission depreciation regulation remains necessary to protect ratepayers.

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<sup>17</sup> NPRM at n. 4, ¶19.

<sup>18</sup> Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, ("Depreciation Simplification"), Comments of GTE, March 10, 1993, at 14.

<sup>19</sup> Depreciation Simplification, Report and Order, FCC 93-452, released October 20, 1993 ("Depreciation Simplification Order") at ¶46. (Emphasis added).

**B. The Commission's Streamlined Filing Procedure Proposal Is Appropriate when Factors Are Within Ranges**

In the NPRM, the Commission proposes a dramatic reduction in the administrative burden associated with carrier filing procedures.<sup>20</sup> Provided that the ILECs select depreciation factors from within the Commission's prescribed ranges, and certify that their selections are consistent with their operations, their filings would be reduced from 170 detailed pages to four summary pages.<sup>21</sup> MCI WorldCom agrees that this proposal would result in significant industry and Commission savings without diminishing the effectiveness of the Commission's oversight.

The Commission also proposes the elimination of formal Commission prescription of depreciation rates if a carrier selects depreciation factors from within the Commission's ranges for all of its accounts.<sup>22</sup> Currently, the Common Carrier Bureau issues a Public Notice each fall listing the change in depreciation accruals and composite rates it proposes for each state for each carrier filing for represcription.<sup>23</sup> At the end of the year, the Commission releases an order officially prescribing the rates for each account of each state of each carrier being represcribed. For each account, the

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<sup>20</sup> NPRM at ¶10.

<sup>21</sup> Id.

<sup>22</sup> Id.

<sup>23</sup> See, e.g., Comments Invited on Depreciation Rate Prescription Proposed for Southwestern Bell Telephone Company, ASD-79, DA 98-1622, released August 26, 1998.

Commission lists the Average Remaining Life, Future Net Salvage, Accumulated Depreciation and Remaining Life Rate.<sup>24</sup>

While MCI WorldCom believes that the current procedure can be simplified, it opposes the elimination of Commission prescriptions. The Commission's prescription orders provide the state commissions and the public with an official notification of the rates approved for each account. Without such a public record, misunderstandings will occur, and the minimal Commission resource savings available from the elimination of this document will be more than offset by the need to respond to ad hoc inquiries from a myriad of parties throughout the year. In short, the elimination of prescription orders would be "penny-wise, but pound foolish."

MCI WorldCom recommends, therefore, that the Commission continue to release an annual prescription order. This order could be simplified, however by showing only the prescribed rate for each account. Indeed, the Commission might further simplify its process by eliminating the separate fall Public Notice and including the summary information normally provided therein in its prescription order.

**C. The Commission's Proposed Range For Digital Switching Is Appropriately Forward-Looking**

In the NPRM, the Commission states that it has completed a review of its prescribed factors for all accounts and found that only one factor requires updating.<sup>25</sup>

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<sup>24</sup> See, e.g., Cincinnati Bell Telephone Company, Memorandum Opinion and Order, FCC 98-11, released January 30, 1998.

The Commission notes that the retirement rate for digital switching equipment has risen from 1.5 percent for 1990-92 to 2.9 percent for 1995-1997.<sup>26</sup> Since the Commission expects this rate to continue to rise, it proposes a reduction in the projection life range for digital switching from 16 to 18 years to 13 to 18 years.<sup>27</sup>

The new projection life range implies an expected retirement rate between 5.6 and 7.7 percent, more than twice the current retirement rate.<sup>28</sup> MCI WorldCom defers to the Commission's proposal for this account, however, given the Commission's proven expertise in prescribing forward-looking projection lives.<sup>29</sup>

The Commission also requests comment on whether its existing confidentiality procedures governing depreciation-related submissions are adequate.<sup>30</sup> Overall, the Commission's procedures strike an appropriate balance between carrier concerns and the need for disclosure of information to ensure effective regulation. In general, detailed historical data has been publicly available, but detailed carrier plans have been held to be proprietary. MCI WorldCom supports the Commission's current procedures.

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<sup>25</sup> NPRM at ¶11.

<sup>26</sup> Id. at n. 40.

<sup>27</sup> Id. at ¶11.

<sup>28</sup>  $1.0/18 \text{ years} = 5.6\%$ ;  $1.0/13 \text{ years} = 7.7\%$ .

<sup>29</sup> Since the Commission began prescribing forward-looking projection lives in 1980, the incumbent LECs' depreciation reserve ratios have increased from 18.6 percent to an historic high of 49 percent in 1997. NPRM at ¶3.

**D. The Commission's Proposal To Expense Net Salvage Is Appropriate**

The Commission proposes to eliminate the future net salvage factor from the depreciation formula and to record salvage and the cost of removal as a current expense in the period incurred.<sup>31</sup> The Commission notes that “the estimation of net salvage is a complex and inexact process that imposes substantial burdens on both the carriers and the state and federal commissions.”<sup>32</sup> MCI WorldCom agrees that the elimination of the future net salvage factor from the depreciation formula is an idea whose time has come for the telephone industry.

The expensing of net salvage was proposed in 1991 by James J. Augstell of the New York commission in an article in the Journal of the Society of Depreciation Professionals.<sup>33</sup> Mr. Augstell explained that this change would lessen the administrative burden of depreciation regulation and remove an area of continued controversy. He also noted that the elimination of speculative salvage and cost of removal estimates would improve the accuracy of the depreciation process. Finally, he suggested that the switch to current period accounting would lead to improved accountability within the carriers, particularly for cost of removal.

Mr. Augstell presented a study on the subject which was first performed in conjunction with his involvement on the National Association of Regulated Utility

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<sup>30</sup> NPRM at ¶12.

<sup>31</sup> Id. at ¶14.

<sup>32</sup> Id.

<sup>33</sup> Gross Salvage and Cost of Removal: The Case for Current Period Accounting, Journal of the Society of Depreciation Professionals, Volume 3, Number 1, at 31.

Commissioners (“NARUC”) Capital Recovery Task Force.<sup>34</sup> In general, his study showed that the change to current period accounting would decrease revenue requirements for most companies. He explained that depreciation accruals have provided for negative net salvage, but that actual net salvage has been either less negative or positive.

Indeed, recent data confirms this analysis. Attachment 1 to these comments shows that Bell Operating Company (“BOC”) salvage and cost of removal amounts have been almost equal since 1991. Net salvage has actually been positive for the last two years for the BOCs. For the six-year period, net salvage has been negligible relative to BOC investment.

Given the minimal effect of current period accounting for net salvage, the Commission should mandate this change for all incumbent LECs. This would ensure continued uniformity in accounting, consistent with the Commission’s responsibility to “prescribe a uniform system of accounts.”<sup>35</sup>

Although the net effect of current period accounting is minimal, the impact on individual accounts varies greatly. For this reason, the Commission should prescribe new depreciation rates, to be effective January 1, 1999, that reflect the elimination of the future net salvage factor. This ministerial prescription could be performed as soon as the carriers report their year-end depreciation reserve balances. Any individual account

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<sup>34</sup> Id. at 32.

<sup>35</sup> 47 U.S.C. § 220(a)(2).

reserve imbalances resulting from this change will be automatically addressed pursuant to the Commission's remaining life procedures.<sup>36</sup>

The Commission's proposed Account 6566, Net Cost of Removal, is appropriate for the recording of both salvage receipts and removal costs.<sup>37</sup> The Commission should, however, require that the carriers maintain subsidiary record categories in Account 6566 for salvage and cost of removal to allow for the monitoring of these amounts.

**E. Mid-Sized LECs Should Continue To Report Theoretical Reserves**

The Commission proposes to eliminate the filing of annual theoretical reserve studies by mid-sized incumbent LECs.<sup>38</sup> MCI WorldCom opposes this proposal.

As the Commission notes in the NPRM, the effectiveness of the Commission's depreciation prescription process and the adequacy of depreciation reserves can be determined by comparing a carrier's book depreciation reserve with its theoretical reserve.<sup>39</sup> This is a simple calculation, performed once a year, but critical to the proper monitoring of a carrier's depreciation situation. Without this report, the Commission cannot compare the ILECs' actual book reserves to the theoretically appropriate

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<sup>36</sup> This change will also affect the inputs for the cost model used to determine universal service requirements. Currently, that model uses the prescribed depreciation lives and salvage. If the Commission makes this change, the model's use of these inputs may need to be adjusted.

<sup>37</sup> NPRM at ¶16.

<sup>38</sup> Id. at ¶17.

<sup>39</sup> Id. at n. 48.



reserves, for each account and in total. There is no reason to exempt mid-sized carriers, which all have revenues exceeding \$112 million, from this basic regulatory requirement.

**F. Elimination of The Low-End Adjustment Would Not Eliminate The Need For Depreciation Regulation**

As explained above, one of the reasons that depreciation must continue to be regulated is to prevent price cap ILECs from manipulating the low-end adjustment mechanism. The Commission seeks comment on whether it should permit carriers to set their own depreciation rates on the condition that they become ineligible for a low-end adjustment.<sup>40</sup>

The elimination of one particular reason for regulation depreciation would have no effect on the other, equally valid, reasons discussed above. The maintenance of just and reasonable rates for interstate services, intrastate services, and unbundled network elements all depend upon depreciation regulation, as does the determination of fair and equitable universal service contributions and subsidies. Thus, the elimination of the low-end adjustment would not eliminate the need for depreciation regulation.

**III. The Commission Should Deny USTA's Petition for Forbearance**

On September 11, 1998, USTA petitioned the Commission to forbear, as of January 1, 1999, from regulating the depreciation and amortization practices of local exchange carriers subject to price cap regulation. USTA contends that, with the elimination of the sharing mechanism, Commission regulation of price cap ILEC

depreciation practices is no longer necessary to ensure that rates are just, reasonable, and not unreasonably discriminatory, and is no longer necessary to protect consumers.

USTA argues further that forbearance from depreciation regulation would be in the public interest and would be consistent with the Telecommunications Act of 1996's amendments to Section 220(b) of the Act. The Commission should deny USTA's petition.

**A. The Change To Section 220(b) Was Ministerial**

USTA suggests that the Telecommunications Act of 1996 (1996 Act) amended Section 220(b) of the Communications Act of 1934 because it recognized “the need for depreciation reform as the telecommunications marketplace changes.”<sup>41</sup> In point of fact, Section 220(b) was changed at the request of the Commission to codify its long-established practice of prescribing depreciation rates for only the largest telephone companies in the nation.

As originally written, Section 220(b) required the Commission to prescribe depreciation rates for all telephone companies “as soon as practicable.”<sup>42</sup> Over the course of sixty years, the Commission found it necessary and practicable to prescribe depreciation rates for less than 100 of the 1300 operating telephone companies. The Commission never found it necessary to prescribe depreciation rates for the vast majority of smaller telephone companies. Accordingly, the Commission requested a

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<sup>40</sup> Id. at ¶18.

<sup>41</sup> USTA Petition at 4.

change to Section 220(b) to repeal the mandatory prescription of depreciation rates for all carriers.<sup>43</sup> The 1996 Act merely affirmed the Commission's long-standing depreciation prescription practice by limiting Commission prescription to "such carriers as it deems to be appropriate."<sup>44</sup>

USTA contends that the depreciation process has been controversial and has consumed significant resources for the carriers it has prescribed pursuant to Section 220(b).<sup>45</sup> USTA greatly exaggerates the administrative burden associated with the depreciation process. The Commission effectively limited the burden associated with the depreciation process by adopting streamlined procedures in 1993.<sup>46</sup> Indeed, as discussed above, the NPRM suggests even greater simplification. The costs associated with depreciation regulation are trivial when measured against the risks associated with premature deregulation of ILEC depreciation practices.

#### **B. Depreciation Regulation Is Necessary to Ensure Just and Reasonable Rates**

Section 10(a) of the Communications Act requires forbearance from regulation if three conditions are met. The first condition requires the petitioner to demonstrate that "enforcement of such regulation or provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that

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<sup>42</sup> 47 U.S.C. §220(b)(1990).

<sup>43</sup> Creating a Federal Communications Commission for the Information Age, Report of the Special Counsel to the Commission on Reinventing Government, February 1, 1995, Appendix A, Item 2.

<sup>44</sup> 47 U.S.C. § 220(b)(1996).

<sup>45</sup> USTA Petition at 6.

telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory.”<sup>47</sup> This condition is not met with respect to depreciation regulation.

USTA argues that depreciation regulation is no longer necessary for price cap ILECs because access prices are determined with reference to the price cap formula, not ILEC costs of service.<sup>48</sup> In particular, USTA contends that “[w]ith the Price Cap Order’s elimination of the sharing mechanism, the [primary] justification for depreciation regulation no longer exists.”<sup>49</sup> But the elimination of the sharing mechanism does not eliminate the need for depreciation regulation. As discussed above in MCI WorldCom’s comments on the biennial review NPRM, depreciation regulation remains necessary for several other reasons.<sup>50</sup>

USTA suggests that the low-end adjustment need not stand in the way of depreciation deregulation because it has rarely been triggered.<sup>51</sup> This fact merely reflects the Commission’s difficulty in setting a productivity factor reflective of the gains achievable in the provision of interstate access. As the Commission addresses this problem, ILECs achieving average productivity gains may find that their earnings are closer to the low-end adjustment trigger. Absent Commission prescription of

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<sup>46</sup> Depreciation Simplification Order.

<sup>47</sup> 47 U.S.C. § 160(a)(1) (emphasis added).

<sup>48</sup> USTA Petition at 10.

<sup>49</sup> Id. at 11

<sup>50</sup> See Section II.A.

<sup>51</sup> USTA Petition at 11-14.

depreciation rates, these ILECs could manipulate their reported depreciation expense to trigger the low-end adjustment mechanism.

USTA suggests that, if an ILEC sought to implement a low-end adjustment, the Commission could review its depreciation practices at that time, with the ILEC responsible for demonstrating that its depreciation practices were reasonable and did not distort its reported earnings.<sup>52</sup> This recommendation is both impractical and inadequate. It is impractical because it would require the review of an unknown number of ILEC depreciation filings each year in the limited time available for access filing review. It is inadequate because it would address only one of the reasons discussed above that depreciation regulation remains critical to the maintenance of just and reasonable rates.

### **C. Depreciation Regulation Is Needed For Consumer Protection**

The second condition of Section 10(a) of the Communications Act requires the petitioner to demonstrate that “enforcement of such regulation or provision is not necessary for the protection of consumers.”<sup>53</sup> USTA’s petition does not satisfy this requirement.

As explained above, even under the Commission’s price cap plan, the maintenance of just and reasonable rates requires the continued regulation of depreciation by the Commission. The premature deregulation of depreciation would allow the incumbent LECs to raise service rates at will and at the expense of consumers.

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<sup>52</sup> Id.

<sup>53</sup> 47 U.S.C. § 160(a)(2). (emphasis added).

Only by maintaining control over incumbent LEC depreciation can the Commission protect consumers from excessive rates.

USTA contends that Securities and Exchange Commission (“SEC”) regulations, stock exchange listing requirements, audit requirements and compliance with GAAP would protect consumers in the absence of depreciation regulation.<sup>54</sup> The Commission has found this not to be the case, as explained above.<sup>55</sup> SEC regulations, stock exchange listing requirements, independent audit requirements and GAAP are all designed specifically to protect investors, not consumers.

**D. Forbearance from Depreciation Regulation is Not In the Public Interest**

The third condition of Section 10(a) of the Communications Act requires the petitioner to show that “forbearance from applying such provision or regulation is consistent with the public interest.”<sup>56</sup> In making this determination the Commission must consider whether forbearance “will promote competitive market conditions.”<sup>57</sup>

Forbearance from depreciation regulation is not in the public interest because, as discussed above, premature deregulation of depreciation practices would permit the ILECs to charge rates that are not just and reasonable or are unreasonably discriminatory. Furthermore, premature deregulation of depreciation practices would retard, rather than promote, competitive market conditions.

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<sup>54</sup> USTA Petition at 15-16.

<sup>55</sup> See Section II.A.2

<sup>56</sup> 47 U.S.C. § 160(a)(3).

<sup>57</sup> *Id.*, § 160(b).

First, many state commissions rely upon the Commission's depreciation prescriptions in the determination of UNE rates. Depreciation deregulation would deprive these state commissions of the balanced perspective of the FCC, and could thereby lead to excessive UNE rates. Such rates would have a chilling effect on competition in the local exchange and exchange access markets, which would be directly contrary to the public interest standard of Section 10(a).

Moreover, the premature deregulation of depreciation would allow the incumbent LECs to accelerate their capital recovery while they retain overwhelming market power. This would have serious implications for the future of competition. If the incumbent LECs were able to recover a disproportionate share of their investment from captive ratepayers, they would be able to unfairly underprice their services as potential competitors struggle for market share. Such a strategy could frustrate competition for years to come to the detriment of the public interest.

**E. The ILECs Have a Depreciation Reserve Surplus, Not a Deficiency**

USTA contends that the Commission has adopted "long asset lives in order to reduce depreciation rates,"<sup>58</sup> and that "forbearance will serve the public interest by providing price cap LECs, like their competitors, the opportunity recover their investments based on competitive market conditions rather than regulatory prescriptions."<sup>59</sup> At the same time, USTA argues that forbearance should not preclude

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<sup>58</sup> USTA Petition at 6.

<sup>59</sup> USTA Petition at 17.

the LECs from recovering “any depreciation reserve deficiencies that may exist.”<sup>60</sup>

USTA’s comments suggest a situation that does not exist.

MCI submitted a report in the Commission’s recent CC Docket No. 98-81 Part 32 Biennial Review proceeding that demonstrated that the depreciation factors prescribed by the Commission are forward-looking and unbiased.<sup>61</sup> This report also demonstrated that the incumbent LECs had a depreciation reserve surplus, not a deficiency, as of January 1, 1998.<sup>62</sup> In short, the report concluded that the Commission’s regulation of depreciation has served the public, and the industry, well.

The Commission confirms this analysis in the NPRM, concluding that “there is no apparent depreciation reserve imbalance.”<sup>63</sup> The Commission also finds, with one minor exception, that there was no evidence that its currently prescribed life ranges are either too long or too short.<sup>64</sup> The Commission notes that “since the Commission’s Depreciation Reform Proceeding in 1980, the life and salvage factors prescribed by the Commission are forward-looking factors that are based primarily on analysis of incumbent LEC investment plans and on judgments regarding the technological

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<sup>60</sup> Id. at 2.

<sup>61</sup> 1998 Biennial Regulatory Review - Review of Accounting and Cost Allocation Requirements, CC Docket No. 98-81 (“Accounting Review”), MCI Reply Comments, September 4, 1998, Attachment A, Report on Andersen Position Paper by Snavelly King Majoros O’Connor & Lee, Inc., pp. 21-26.

<sup>62</sup> Id., Attachment 4. Should the Commission forbear from regulating depreciation at some future date, the incumbent LECs would clearly have no basis for recovering any purported reserve deficiency.

<sup>63</sup> NPRM at n. 48.

<sup>64</sup> Id. at ¶11. As discussed above, the Commission proposes to change the range for Digital Switching from 16-18 years to 13-18 years.



obsolescence and economic viability of the assets, rather than a focus on the historical equipment life trends.”<sup>65</sup>

#### **IV. Conclusion**

For the reasons stated herein, the Commission should deny USTA’s petition for forbearance from depreciation regulation for price cap carriers. At most, the Commission should adopt the limited proposals outlined in the Notice, with the modifications suggested by MCI WorldCom.

Respectfully submitted,  
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November 23, 1998

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<sup>65</sup> NPRM at n. 6.

**Bell Operating Company Net Salvage**

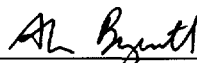
(Dollars In Thousands)

<b><u>Year</u></b>	<b><u>Beginning Investment</u></b> a	<b><u>Salvage</u></b> b	<b><u>Cost of Removal</u></b> c	<b><u>Net Salvage</u></b> d = b - c	<b><u>Percent</u></b> e = d / a
1992	192,988,103	526,455	503,224	23,231	0.01%
1993	197,392,112	482,436	523,794	-41,358	-0.02%
1994	204,071,396	447,355	475,464	-28,109	-0.01%
1995	210,316,513	413,646	446,802	-33,156	-0.02%
1996	218,435,899	472,347	395,240	77,107	0.04%
1997	228,327,832	<u>614,322</u>	<u>432,235</u>	<u>182,087</u>	0.08%
<b>Total</b>	—	<b>2,956,561</b>	<b>2,776,759</b>	<b>179,802</b>	--
<b>Average</b>	<b>208,588,643</b>	<b>492,760</b>	<b>462,793</b>	<b>29,967</b>	<b>0.01%</b>

Source: ARMIS 43-02 Reports, Tables B-1 and B-5

### STATEMENT OF VERIFICATION

I have read the foregoing, and to the best of my knowledge, information, and belief there is good ground to support it, and that it is not interposed for delay. I verify under penalty of perjury that the foregoing is true and correct. Executed on November 23, 1998.



---

Alan Buzacott  
Regulatory Analyst  
1801 Pennsylvania Ave. NW  
Washington, D.C. 20006  
(202) 887-3204

## CERTIFICATE OF SERVICE

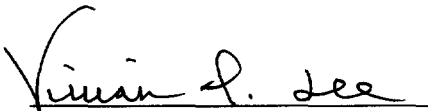
I, Vivian I. Lee, do hereby certify that copies of the foregoing Comments were sent via first class mail, postage paid, to the following on this 23rd day of November, 1998.

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\*\*HAND DELIVERED

  
Vivian I. Lee